

Demonetisation: the great reset, a year later

Prime Minister Narendra Modi's flagship economic agenda of demonetisation, that stunned the nation as a financial Pokhran, has been caught in the political crossfire between Mr. Modi and the Opposition from the word 'go'. When millions (a word that was hyped by the media) were standing in queues before banks and there was hardship caused to diverse people, the Opposition thought that Mr. Modi had found himself in a tornado that would sweep him away. They began a massive campaign against demonetisation and Mr. Modi. With the media feeding the Opposition with news of near financial anarchy, and in turn the Opposition feeding the news hungry media by shutting down the winter session of Parliament, and the two together creating the ecosystem in which the Supreme Court justifiably said there could be "riots", the opponents of Mr. Modi concluded that his end was very near.

But facing the biggest challenge of his political life, Mr. Modi went to the people, telling them that the measure was directed at corruption and black money — the terminology which the masses easily understood — and [asked them to bear with him for 50 days](#). Crores of Indians stunned the media, the Opposition and even the world by patiently standing in queues for days and giving him total support. They endorsed demonetisation by voting for the Bharatiya Janata Party, giving it unprecedented victories in local body elections in Chandigarh, Mumbai, Maharashtra, Gujarat, Odisha and even in the Assembly polls in [Uttar Pradesh](#), [Uttarakhand](#), [Goa](#) and [Manipur](#). But the hostile political build-up turned the demonetisation debate into a street fight, with both the BJP and the Opposition appealing to the masses in the language they easily understood; the Opposition using hardship to incite people's anger against demonetisation and the BJP appealing for their support terming it as a war on black money. The hardship versus black money focus reduced the discourse on demonetisation — a multidimensional venture — to just a single point; a war on black money, which won the BJP the people's support.

The reductionism diminished the debate to a sole test of the quantum of demonetised notes returned to the Reserve Bank of India (RBI). But the demonetisation project formed a much larger landscape. Its fundamental aims were many. It terminated the asset price-led, spurious jobless growth and averted a crisis in the making. The rise in the share of high denomination notes (HDNs, 1,000/500) in the total currency from 47% in 2004 to 78% (2004-10) fuelled unprecedented asset price rise — gold, stock and land prices rose by 10 times in the six years over the previous five years (1999-2004). The high GDP growth (8.5%) in six years (2004-10) was largely led by private consumption powered by the financial and real estate sectors — both driven by cash. The rise in private consumption (60%) in these six years over the previous five years was directly sourced in the rise of 69% in finance and real estate in that period. Thus, the high growth (8.5%) between 2004 and 2010 was fake, yielding only 2.7 million jobs as against 60 million jobs which the moderate growth of 5.4% between 1999 and 2004 had produced.

Here is an example of how the asset price-led growth had hurt real growth. Liases Foras indices of housing affordability and prices (both equal at 100 in January 2005) peaked in March 2014, with the index of price curving steeply to 529 and affordability slowing at 173. This huge affordability gap, of almost three times, was due to cash driving up land prices and secondary housing market that constituted two-thirds of housing buys. With a 95% shortage in affordable housing, this wide gap virtually killed real housing growth since 2011.

Demonetisation is an effort to reverse this dangerous trend. Had this intervention not taken place, by 2021, HDNs could have touched as high as 36-40 lakh crore, which would have dynamited the real economy through asset price inflation — much like subprime lending did in the U.S. before the 2008 crisis.

Had the government aligned demonetisation with the Income Declaration Scheme, 2016, it would have fetched a minimum of 2-3 lakh crore as tax upfront. By unintelligently separating them, it is now chasing demonetisation depositors for tax. Yet, the black money agenda of demonetisation is no failure, though ill-executed. Black money of 45,000 crore has been uncovered and 2.9 lakh crore of cash deposits are under tax probe. Against this whopping 3.35 lakh crore, yields in previous disclosure schemes have been minuscule. Following demonetisation, there are 56 lakh more assesseees, advance tax receipts have gone up by 42% and self-assessment tax risen by 34%. It has also led to an attack on benami assets. Even as intelligence agencies note a 50% drop in hawala-related calls post demonetisation, nearly 2.24 lakh shell companies that have been used for hawala have been uncovered; 35,000 have been found laundering 17,000 crore; one of them, 2,484 crore.

Demonetisation means much more. The currency to GDP ratio is down from 13% to 9%, post-demonetisation. Household financial savings have risen and savings in currency form crashed. Interest rates are down, with the RBI cutting rates by 25 basis points, and banks by 96 basis points. According to a study, digital payments have accelerated by 93% between January and June 2017. Without demonetisation, it would have just grown by just 21% — by a fourth of it. Demonetisation has forced the extra cash floating around into term and time deposits, which have risen by 17 lakh crore. A huge formalisation of the informal economy, which generates half the nation's GDP and 128 million jobs or 10 times the jobs in the formal sector, is under way. Demonetisation is an effort to bring about a fundamental shift in the economy.

That GDP growth would slacken for a year is implicit. But it was not as bad as when Paul A. Volcker, as U.S. Fed chief, applied Milton Friedman's monetary theory and contracted bank credit, a kind of demonetisation for the U.S. That led to the U.S.'s GDP, far from rising, turning minus 3% in 1982, though it later vaulted to 6% in 1983 and 8% in 1984. But despite the fact that demonetisation would slow the GDP, the government, under attack by economists and the Opposition alike, was in denial mode. Now, the RBI expects growth to improve in the second half of (calendar year) 2017. The rise of the Index of Industrial Production (IIP) by 4.5% in August 2017 over August 2016 and 8 core sector IIP (this consists of eight core industries data) for September by 5.2% seem to signal high growth ahead, though the intervention of the goods and services tax may delay it for a while.

A caveat at the end. Demonetisation has robbed the informal sector of non-formal credit; the formal credit assured to them through the Micro Units Development and Refinance Agency (MUDRA) formula has not been fulfilled as yet. MUDRA was premised on the assumption that banks cannot reach credit to the informal sector and need last-mile private credit intermediaries, which the RBI opposes. The government must convince the RBI on the need for MUDRA as conceived. Subject to this, demonetisation, in sum, is a fundamental corrective to the economy much like liberalisation was in 1990s. Sadly, this vital aspect is missing in the current discourse.

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